

October 11, 2007

Frequently Asked Questions About the Federal Budget

1. What were the federal revenues, spending, and deficit for fiscal year 2007?

2007 Federal Budget Summary		
Total Budget (Including Social Security)		
Revenues: \$2.568 trillion	Spending: \$2.731 trillion	Deficit: \$163 billion
On-Budget (Excluding Social Security)		
Revenues: \$1.933 trillion	Spending: \$2.277 trillion	Deficit: \$344 billion

Source: Office of Management and Budget

2. What is the expected deficit for fiscal year 2008?

On August 23, the Congressional Budget Office (CBO) projected that the 2008 deficit would be \$155 billion. However, CBO assumes that revenues and spending follow current law. Any changes to current spending or revenue policies will affect CBO's deficit estimate.

3. What is the long-term budget forecast?

The long-term budget outlook is daunting. Over the long-term, if the budget remains on its current course, large, unsustainable deficits are expected. The long-term challenge calls for change, and Congressional Democrats are heeding that call. The budget resolution passed by Congress in May gets the budget back on track. Consistent with the pay-as-you-go principle that both the House and Senate follow, the Congressional budget resolution requires that any new net mandatory spending or revenue changes are paid for, while allowing for modest discretionary investments to address long-standing needs. The federal budget returns to balance in 2012 under the budget resolution.

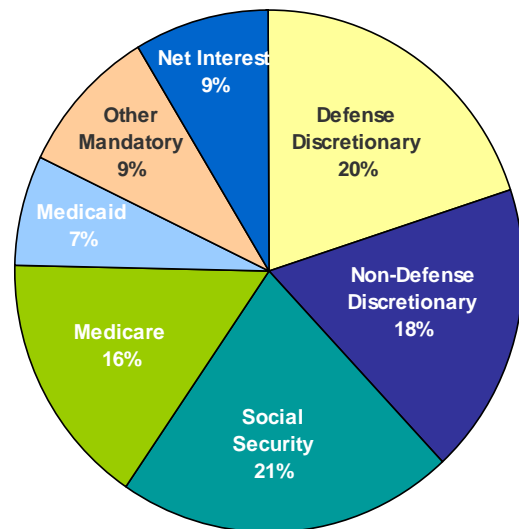
4. What comprises federal spending and revenues?

Major Categories of Spending <i>2007 Outlays</i>	
Discretionary spending:	
Defense	\$547 billion
Non-Defense	\$495 billion
Entitlements:	
Social Security	\$581 billion
Medicare	\$436 billion
Medicaid	\$192 billion
Other Mandatory *	\$445 billion
Miscellaneous receipts that offset spending:	\$-196 billion
Net interest	\$235 billion

* Civil Service and Military Retirement, SSI, EITC, Veterans' Benefits, etc.

Major Categories of Federal Spending:

2007 Outlays



CBO projects that total federal government spending (including Social Security) for 2007 will be \$2.7 trillion. “On-budget” spending will be \$2.3 trillion. The additional “off-budget” spending, which includes Social Security and net spending of the Postal Service, is the remaining \$452 billion. Two-thirds of all federal spending is for entitlement programs (known also as mandatory spending), for which spending fluctuates based on several factors including the number of eligible beneficiaries. The remaining one-third of government spending is known as discretionary, and is provided through the 12 annual appropriations bills. Slightly more than half of all discretionary funding is for defense.

According to CBO projections, the federal government will collect \$2.6 trillion in revenues in 2007 from various sources. Individual income taxes provide \$1.2 trillion (about 45 percent) of all revenues.

2007 Revenues By Source		
	\$ in Billions	% of Total
Individual Income	1,169	45%
Corporate Income	376	15%
Social Insurance	868	34%
Excise	66	3%
Estate and Gift	25	1%
Customs Duties	26	1%
Miscellaneous	46	2%

5. What is the national debt and how much of it is foreign held?

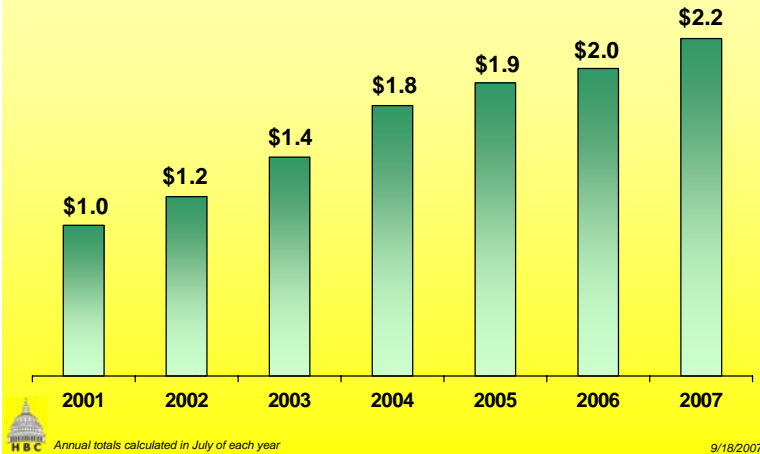
The gross federal debt refers to the total value of outstanding notes, bonds, bills, and other debt instruments issued by the Treasury and other federal agencies. That debt is referred to as federal debt or gross debt. It has two components: debt held by the public (federal debt held by nonfederal investors, including the Federal Reserve System) and debt held by government accounts (federal debt held by federal government trust funds, deposit insurance funds, and other federal accounts).

On August 31, 2007, the debt was \$9.0 trillion, meaning that each American’s share of the national debt is nearly \$30,000. *(To view up-to-the-minute information regarding the national debt and the per-capita debt-share, please visit www.budget.house.gov)*

The cost of financing the federal debt is an increasingly expensive component of total federal spending. Indeed, “net interest” is now one of the fastest growing functions of the government’s budget. In August, CBO projected net interest payments of \$235 billion in 2007, nearly 9 percent of the entire federal budget.

Amount of Foreign-Held Treasury Securities More Than Doubles Under Bush Administration

Trillions of Nominal Dollars



Debt held by the public represents around 56 percent of the gross national debt. Under the Bush Administration, the portion of the debt held by the public that is owned by foreign investors has exploded. Over the last six years, foreign-held debt has more than doubled, from \$1.0 trillion in January 2001 to \$2.2 trillion in July 2007. In fact, America is relying on foreign investors to purchase most of its debt these days – more than 80 cents of every dollar of new debt since 2001 has been purchased by foreign investors. China alone has increased

its holdings of U.S. Treasury Securities by nearly 500 percent in the last six years, from \$74 billion in July 2001 to \$408 billion in July 2007. Other significant shareholders of foreign-held U.S. public debt include Japan (\$611 billion), the United Kingdom (\$210 billion) and buyers categorized as “Oil Exporters” (\$124 billion).

6. How does the budget process work and what role does the budget resolution play?

Through the budget process, Congress can evaluate and plan the nation’s fiscal situation as a whole. While appropriations bills and authorizing legislation address discrete portions of the federal budget, the budget resolution provides an overall framework which includes the total planned cost of federal programs, revenues, and the surplus or deficit. (For a detailed overview of the federal budget process, see CRS Report 98-721, Introduction to the Federal Budget Process, by Robert Keith.)

The budget resolution allows Congress to make a statement of its major priorities by choosing to focus resources among different budget functions such as education, transportation, and defense. Budget resolutions are agreed to annually and cover the coming fiscal year and at least the next four years. They set limits for annual discretionary spending, place limits on the amount of spending that authorizing committees can approve, and establish a revenue floor for the tax-writing committees.

The budget resolution may include a process for “reconciliation,” which sets forth special procedures for legislation that changes revenues or direct spending to achieve a specified budgetary result.

The resolution that Congress passed this Spring sets the budget on a fiscally responsible path, reaching balance in 2012. It complies with the pay-as-you-go principle, which requires that all new

net mandatory spending or tax cuts be offset. It rejects the President's harmful cuts in discretionary funding and makes a down payment towards addressing some long-standing needs within the tight fiscal constraints of the overall budget plan.

This year's action on the congressional budget resolution is in contrast to previous Congresses; in two of its last three years in the majority, the Republican Congress failed to pass a final budget resolution. That failure meant that Congress could not consider spending and tax cut measures within the context of an overall fiscal framework.

7. How does the new House pay-as-you-go rule help restore budget discipline?

During the 1990s, the "pay-as-you-go" system, or PAYGO, created budget restraints on both spending and revenues that helped turn large deficits into surpluses. That statutory PAYGO system required Congress to offset any net direct spending increases or tax reductions with other savings. In this decade, Congressional Republicans not only violated PAYGO and failed to renew it when it expired, they also repeatedly used fast-track reconciliation procedures to push tax cuts through Congress that made the deficit worse, not better.

As one of its first acts in January, the House of Representatives adopted a PAYGO rule prohibiting consideration of direct spending or revenue legislation that worsens the deficit outlook. The rule reinstated pay-as-you-go discipline at the very beginning of the Congress – and the House has adhered to the rule ever since. The House also adopted a separate rule stipulating that fast-track reconciliation procedures – originally designed for tough, budget-improving compromises – can no longer be used to expedite the passage of legislation that increases the deficit.

8. Have tax cuts helped or hurt the budget and the economy?

A July CBO analysis confirms that without the 2001 and 2003 tax cuts, the budget would be in surplus this year and the following four years. The budget would be in surplus even accounting for any "dynamic" effects of the tax cuts on the economy, which CBO says "have largely dissipated by now" and are "probably small." CBO estimates that the cost of the tax cuts in 2007 alone, including debt service, is \$211 billion, and that even with "dynamic" offset the cost is at least \$195 billion.

Some Republicans in Congress argue that tax cuts will result in such strong economic growth that the expanded economy will actually generate sufficient net revenue to pay for the cost of the tax cuts. These claims are not supported by data. The President's former top economist, Greg Mankiw, wrote that there is "no credible evidence" that tax cuts pay for themselves. While there has been some unexpected growth in revenues over the past several years, this is largely driven by huge corporate profits, and growing income inequality that is pushing a larger portion of earnings into higher tax brackets.

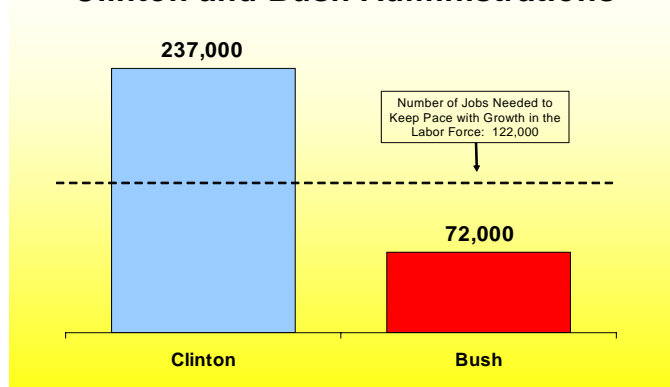
In addition, because the government is in deficit, any benefits attributed to the tax cuts must be balanced against the costs of additional Treasury borrowing to finance the tax cuts. Not only must this extra borrowing be repaid with interest (often to foreign lenders), but it also carries other

negative economic consequences, such as upward pressure on interest rates and reduced private investment.

9. Is the economy rebounding?

Since 2001, real income for a typical family has fallen, 4.9 million more Americans now live in poverty, more workers are unemployed – all while energy prices have climbed. These factors explain why many Americans have not benefitted from the current economic “expansion.” The economy, which created more than 200,000 jobs per month between 1993 and 2000, has averaged only 70,000 new jobs a month since 2001 – only about half the pace needed to keep up with the growth of the working-age population. This weak job market has left over one million more workers unemployed and increased long-term unemployment by 84 percent. In fact, American workers are more productive than ever, but they are not benefitting in a manner consistent with their increased output. Productivity has grown robustly since 2001, yet the real income of a typical family has fallen by almost \$1,000. The most vulnerable citizens have fared the worst: in 2006, the poverty rate was 12.3 percent – that is over 36 million Americans living in poverty.

Average Monthly Job Gains Under Clinton and Bush Administrations



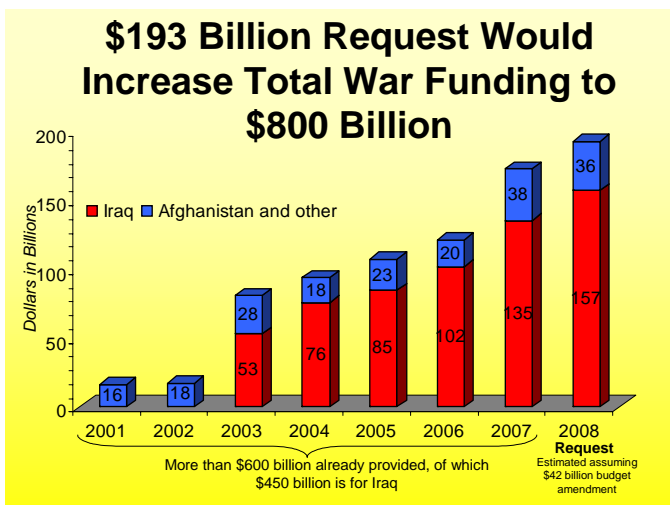
The current expansion is now the weakest since the end of World War II. Since the implementation of the 2001 and 2003 tax cuts, economic growth has failed to match CBO’s estimate of economic growth without the tax cuts. The latest report of the Bureau of Economic Analysis revised real GDP growth downward for all three years between 2004 and 2006 – for a cumulative reduction of 0.8 percentage points in measured real GDP. Leading forecasters are now also revising their economic outlooks downward, including the Administration’s own economists, who in July lowered their forecast for real GDP growth for 2007 from 2.7 percent to 2.1 percent.

10. How much are the wars in Iraq and Afghanistan costing?

More than \$600 Billion Provided to Date

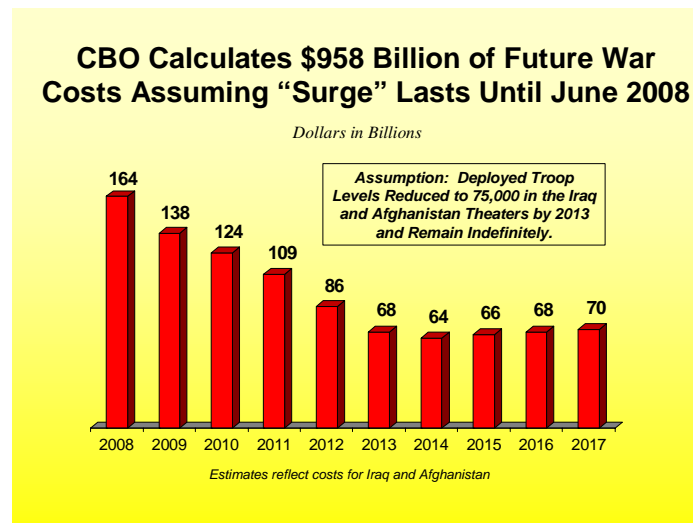
— Through 2007, more than \$600 billion has been made available to finance all war operations, which include Operation Iraqi Freedom, Operation Enduring Freedom (Afghanistan and other counter-terrorist operations), and Operation Noble Eagle (enhanced security at military installations here at home). Approximately \$450 billion

\$193 Billion Request Would Increase Total War Funding to \$800 Billion



of this total was provided for operations in Iraq alone. For the first half of 2007, the Department of Defense (DoD) obligated \$12 billion per month for war operations, \$10 billion of which was for Iraq.

2008 War Costs Could Reach Nearly \$200 Billion — For 2008, the Administration’s budget includes \$151 billion for military operations and reconstruction in Iraq and Afghanistan. However, this estimate does not cover any costs associated with continuing the troop “surge” beyond September 30, 2007. Consequently, the Administration will soon submit another war request for 2008 to cover additional military and reconstruction costs, which will total at least \$42 billion.¹ A \$193 billion request would be the largest yet, \$20 billion above the amount provided for 2007, and would push total war costs to approximately \$800 billion and funding for Iraq operations to about \$600 billion.



War Operations Could Cost Nearly \$1 Trillion over the Next Ten Years — It is difficult to say with precision how much future operations will cost given the uncertainty of what our troop level commitments will be in Iraq and Afghanistan. However, one possible scenario explored by CBO is that deployed troops in the Iraq and Afghanistan theaters could draw down from the current 220,000 level to a steady-state level of 75,000 troops by 2013. Based on this scenario, CBO calculated the federal government would need to budget an additional \$958 billion for 2008 through 2017.

¹Defense Secretary Robert Gates testified that DoD will need \$42 billion more for 2008. The State Department will also be requesting additional funds, however, the amount is not yet known.